What Are Commodities?

Commodities: you have probably heard the term before, but what does it really mean? Simply, commodities are goods like beef, gold or lumber. When farmers and other producers put their goods up for sale they are selling commodities.

But, you may be thinking, I don't raise cattle or mine gold... how can I trade commodities? You will be acting as a speculator or a middleman. For instance, let us follow the life of some corn and I will show you how you fit into this picture.

Imagine a small field of corn growing on a farmer Joe's farm. This particular field of corn is still too young to be sold, but farmer Joe has been watching the corn market by checking the price of a bushel of corn in the newspaper every morning. He has watched the price of a bushel of corn go from $3.01 per bushel to $3.16 per bushel over the last month. He knows that it costs him about $2.50 per bushel to break even farming the corn. So when he wakes up on Wednesday morning and he reads in the newspaper that the price of corn has gone to $3.25 per bushel, he decides that he is going to sell his field of corn at that price. He figures that at $3.25 per bushel, he is pulling in a decent profit on his crop. He realizes that the price of corn may continue to go up or it may go lower… no one really knows. He is willing to sell because he wants to lock in that price for his corn. So farmer Joe calls up his broker, and tells his broker that he wants to sell his corn. But farmer Joe's corn is not going to be ready to harvest until 3 months later. So farmer Joe sells his corn with the understanding that he will deliver that amount of corn 3 months from that day. But who is going to agree to pay $3.25 per bushel for farmer Joe's corn crop?

That is where we come in as speculators or middlemen… Since the price of corn varies daily and millions of bushels are bought and sold everyday, there is an opportunity to make money by buying farmer Joe's corn at $3.25 per bushel and waiting a few days then selling it to someone else for $3.35. Looking at our example, let us say that we decide to buy farmer Joe's entire field of corn (which turns out to be 5000 bushels of corn) for $3.25 per bushel. In reality, all we have to do is put up a deposit to say we are going to buy 5000 bushels; we do not have to put up all of the money (this is all described in detail in our 200 Level Courses). The next day farmer Joe checks the price of corn and it is at $3.40 per bushel. The day after that, farmer Joe checks the price of corn and it is at $3.55 per bushel. He wishes that he had waited two more days to sell it to us, but he does not feel that bad because he still made about 75 cents per bushel. It cost him $2.50 to make and he sold it for $3.25. We decide that it is time to sell the 5000 bushels we bought from farmer Joe to someone else for $3.55 per bushel. We end up making 30 cents per bushel in just two days! 30 cents per bushel times 5000 bushels is $1500.00 in two days!

This story, although slightly simplified, is how easy it is to turn a decent profit in a short period of time trading commodities. In our 200 Level Courses we teach you how to spot markets that have excellent potential for profit and, better yet, we teach you how to practice without risking any of your own money while you test these market strategies to prove that they work.

VISIT…

With the possibility of great gain is also the possibility of great loss. When trading commodities there exists an unlimited potential for loss, however there are also ways of trading where you can have a predefined and completely limited risk. One of the great benefits of taking our courses is that we go over all the different methods used in commodity trading. We will teach you how to completely limit your risk to a level you are comfortable with by teaching you numerous trading styles.
One of the best ways to limit risk in commodities is to use options. By enrolling in our 200 Level Courses you will learn how to do two important things:

1. How to Practice with No Risk of Loss - We will teach you how to practice trading commodities without spending any money. You can practice and test the principles we teach you

2. How to Predefine Risk - We teach you everything you will need to know about completely limiting your risk. You will learn how to use options in conjunction with trading commodity contracts to limit your potential for loss to any amount you set.
Remember that taking our 200 Level Courses is 100% Risk Free! You can try our strategies out without spending a penny. You have nothing to lose and everything to gain. Where else can you get an education on investing that guarantees you up front with a no risk approach that you will make money? No where else but here

Why Would I Want to Trade Commodities?

There is really only one reason to trade commodities… to make money. Commodities allow you to make large sums of money in relatively short amounts of time, with only a small initial investment. What allows you to do this is leverage. When you trade commodities you are putting the power of leverage on your side.

What does leverage do for me?

Just how leverage in the commodity markets can help you is shown in the following example. You can control $1,000,000 eurodollars for just under $600. What does this mean? Well, a eurodollar is an American dollar deposited in a European bank. As the interest rate of these European banks fluctuates the value of the eurodollar changes with it. So if the interest rate changed by just .1 % (that is one tenth of one percent) then the $600 you invested in eurodollars would be worth $850. If it changes by .3 % your money is more than doubled! This is the power of leverage. You are controlling a million dollars of currency with $600.
You may be asking... but what if the interest rates change in the opposite direction? Can't I lose money just as quickly? Yes, you could if you did not know how to limit your losses.
In addition to limiting your losses, we teach you the most difficult concept to understand in trading commodities. It is a secret that you will be sharing with all your friends...
You may have heard stories about people losing everything in the commodity markets... yes there are a few people that have lost large amounts of money trading commodities. These people were greedy. They tried to "get rich quick" and they did not use the

protection that we teach you about in our 200 Level Courses. You can safely trade commodities and accumulate the wealth you deserve.

Are you ready to trade commodities? If you are then you may be wondering, "how much money will I need to get started in this business?" Well, you will need to open a margin account with a broker. The minimum amounts vary from broker to broker, but you will most likely need at least $2000. We do not recommend starting with any more than $5000 even if you have half a million dollars sitting in the bank.

What Is the Difference Between Technical Analysis and Fundamental Analysis?

There are basically two schools of thought when we talk about market analysis: Technical Analysis and Fundamental Analysis. Let us start with Fundamental Analysis. Fundamental Analysis is the study of the fundamentals of the market. "Great," you say, "What are fundamentals?" Fundamentals are all things that affect the supply and demand of the underlying commodity. For example, if you were analyzing the price of wheat and you thought that the price of wheat was going to go up because there is a draught in the mid-western United States, then you would be basing your analysis of the wheat market on fundamentals.

Technical Analysis, on the other hand, is the study of the market based on a chart of its price data like the one above. If you were to look at the chart of the price of wheat over time and saw that the price of wheat is the lowest it has been in 20 years, then you are said to be using Technical Analysis. You do not need to know anything about the

underlying commodity to be a Technical Analyst and that is one of the advantages of being a Technical Analyst. If you wanted to study the fundamentals of Coffee, then you would want to know everything about coffee: how it is grown, what the planting cycles are, who the big buyers of coffee are, what are their plans in the future and how would that affect the demand for coffee and so on. The problem in researching coffee is that it takes a very long time to find out this information and then even more time to examine and interpret it. Technical Analysts claim that all of the fundamentals, or things that affect the price of a commodity, are shown on the price chart anyway. This actually makes sense if we think about in terms of the laws of supply and demand: if the supply of coffee goes up and the demand stays the same then the price will go down. This supply and demand relationship can be seen as a price drop on a price chart.

What are the Differences Between All These Exchanges (What are the CME, CBOT, COMEX, etc.)?

An over simplified view of the different exchanges is to imagine each exchange as a supermarket. Some supermarkets only carry certain brands of items just like certain exchanges only carry certain commodities or other investments. For instance the NYSE or New York Stock Exchange deals primarily with stocks. While the CME or Chicago Mercantile Exchange deals primarily with "farm" type goods (live cattle, feeder cattle, pork bellies). There are different stock and commodity exchanges just like there are different supermarkets. You can "shop" for stocks at the New York Stock Exchange or the American Stock Exchange, but each deals with different stocks. The same is true for commodity exchanges: you can shop at the Chicago Board of Trade (CBOT) but you can not buy the same commodity at the Chicago Mercantile Exchange (CME).

How Can I Get Started Investing in Commodities?

If you want to start investing in commodities, the first thing you should do is educate yourself about the markets and how the markets work. We feel the best way to do that is to take our courses. Everything you need to know to get started profitably investing in commodities is covered in the 200 Level Commodity Courses. Our 300, 400 and 500 level courses will give you that added edge that will boost your profits and make you a more confident trader. Of course, if you decide not to take our course we recommend that you thoroughly read up on the commodity markets.

If you feel that you are already knowledgeable enough to start investing in commodities, then we recommend that you call a broker to get started. If you are new to trading commodities we recommend that you try first trading with a full service broker. A full service broker will, generally, educate you more than a discount broker.

What Happens When the Prices Go Down?

In commodities, probably the most difficult principle to understand is how to profit from the markets when the price is falling. It is actually just as easy as buying a contract and selling when the price goes up. In commodities buying low and then selling at a profit later, when the price goes up, is called going long. When we sell when the prices are high and buy it back later, when the price has gone down, we are said to be short the market. I know that this concept is the most difficult to understand. We have devoted a large portion of our 200 Level Commodity Courses to teaching you this powerful, but difficult to understand concept.

Please take advantage of our offer to take our 200 Level Courses. If you do not make money on paper in 90 days, then return it for a full refund of your tuition. You are risking nothing. You will learn everything you need to know to profitably trade commodities.

What is Stock?

How many times over the past few years have you turned on the news only to hear that technology stocks are up, industrials are down, or the Dow Jones has reached a new high?
Have you wondered what, exactly, everyone is talking about when they discuss the stock market?
You may have participated in some of these conversations, and if you invest in a mutual fund you probably own stock. But what exactly is a stock?
Shares of stock represent individual pieces of ownership (or equity) in a corporation. These corporations issue shares of stock as a means of raising business capital. Investors who buy these shares of stock either during an initial public stock offering or later in a secondary market become partial owners of the firm. Stocks shares are bought and sold on an open market and earn income in two ways. First, stocks earn a long-term shareholder income by payment of dividends, which are regular distributions of a company's profits to its shareholders. Second, shareholders that trade more often also earn income by transacting shares at varying prices. Prices of stocks are dependent on investors' expectations of the value of a firm at any point in time. For example, if an investor buys shares of a firms stock at one price and sells them at a higher price, the difference between the two prices is profit that the investor earns.
There are three basic categories of stock available for public purchase: common stock, preferred stock, and stock options.

What is the difference between common stock and preferred stock?

Have you ever looked at the stock quotes in the newspaper and noticed that a company is listed more than once? Very often, large corporations will offer more than one type of stock. To keep things simple, we'll assume that companies offer two types of stock: common and preferred. If you look up the stock quote for the DuPont company (traded on the New York Stock Exchange) you'll notice that it is listed twice, once as DuPont and once as DuPont pfB. The first listing, DuPont, is the common stock for the company. The second listing, DuPont pfB, is the preferred stock listing. Now you may ask, what is the difference between these stocks?
Common stock is the most popular type of stock traded in the United States. These shares are sold by corporations and then traded among investors. A common stock share is a claim to the residual net income of a company, that is, the income after all expenses and taxes are paid. Every common stock share also represents a right of ownership over the firm. Shareholders with holdings in a firm often vote for the directors of the corporation and can vote directly on many policies. Investors who buy common stock may expect to earn dividends as part of their profits, and hope that the stock price increases so that their investment will become more valuable. There are risks, however, in investing in common stock. There is a very real possibility that dividends could significantly decrease or cease all together during periods when the company is not profiting. Stock prices may also fall, eroding the value of the investment.
Shareholders of common stock are residual claimants. Therefore, they are the "last in line" for payment in case the company must liquidate (sell off all assets). Creditors,

often commercial banks, are paid before the shareholders receive any money. However, the liabilities of the shareholders as owners of the company are limited. If the corporation ends up with a negative net worth after liquidation, the individual shareholders lose the value of their claim (the money they invested in the stock), but they cannot be required to put in more money to pay off the debts of the company. Preferred stock, like common stock represents ownership in the issuing corporation. Preferred stock, however, doesn't provide all the privileges of ownership that are normally associated with common stock. Most preferred stock is issued as nonvoting stock.
There is also less risk associated with owning preferred stock. The amount of the dividend is set and paid before the dividends on common stock. Preferred stock can be thought of as a cross between a bond and a common share of stock. This type of asset establishes a fixed payment per year that is classified as a dividend. Common stocks pay dividends; however, they are based on the firm's performance, not a specified payment. These stocks are classified as "preferred" because their fixed dividend is paid before dividends are distributed to holders of common shares. Therefore, if a firm has a period of poor performance, the preferred stock holders may get paid a dividend while the common shareholders receive nothing. However, if revenues of the corporation are not sufficient to pay contractual dividends to preferred stockholders in a given time period, the firm incurs no liability.

Why would I want to invest in the stock market?

Why do almost 40% of American households have some type of investments in the stock market? Because it's a great way to get your money to work for you!
Let's think about all of the places where you can save your money.

1. Under your mattress: This is the worst place where you can save your money. It may seem safe, but there is no guarantee if it is lost or stolen. To make matters worse, inflation will erode the value of the money you have saved, making it worth less and less the longer it stays under that mattress. The only time that this may be a good place to keep money is during times of deflation (like during the worst times of the Great Depression!), which is not likely to happen anytime soon.

2. Savings accounts: Believe it or not, savings accounts at commercial banks are only slightly better for your money than under your mattress. Banks, through the FDIC, can guarantee your savings up to $100,000, but inflation can still eat away at your hard-earned cash. The interest rate paid on savings accounts is usually less than the inflation rate (think about how much you are making now, it's probably between 1% and 3%). So, just like when your money is under a mattress, the value of your savings will erode over time if it is just kept in a savings account.

3. Bonds: An investment in the bond market can be a solid decision if the investment is made at the appropriate time and in the appropriate security. However, the bond market can also be a very risky place, and often the returns on these riskier investments are

not't justifiable. Bonds can make investors money in a couple of ways. First, through regular payments, usually near the interest rate (right now, bonds pay around 5 to 6 percent). Second, through changing bond prices. However, bond prices are currently very high because of the prevailing low interest rates in the economy, so investors do not anticipate bond prices going any higher. If you bought a bond now, you would probably pay a very high price and you would receive your regular payment, but realistically the price of the bond will only go down over time and erode the value of your investment.

4. Stocks: If you want to make money in the long-run and can tolerate some short-term fluctuations, then the stock market is where you want your money to be. Historically, the stock market has returned just over 10% a year on investments. That is more than bonds, cash reserves, or savings accounts. Investing in the stock market also provides protection from inflation. Inflation in the United States has averaged around 3% for the past 60 years. That erodes most of the profit made on bonds and cash reserves, but still leaves a significant amount of profit from investments in the stock market. Yes, investing in the stock market is risky. There have been times when the stock market has fallen significantly and taken many investors down with it, but inevitably the market comes back and if those same investors had just waited out the downturn, then they could have made all of their losses back and even had a profit. Don't forget though, that the stock market has had great performances as well, like right now! The stock market is up over 20% just for 1998 alone so far. Not many investments have even come close to the returns of the stock market during the 1990's.

How do I make money investing in the stock market?

There are two types of returns that you as an investor can expect from investing in the stock market: cash dividends and capital gains.

Cash dividends, often called just dividends, are that part of a company's after tax earnings that management decides to distribute to its stockholders. Remember that stockholders are part owners of a company. Therefore, when a company has made a profit, that is they have after-tax earnings, the stockholders are entitled to share in these profits. A company's board of directors meets regularly, usually quarterly (four times a year), to decide whether a dividend will be paid and if so, the amount and when it will be paid. For example, suppose that company A made $100,000 in profits during the first quarter of 1998 (January-March), and that company A has 10,000 shares of stock outstanding. Having 10,000 shares of stock outstanding means that the general public, investors like you and me, own these 10,000 shares. At the quarterly meeting the board of directors decides that investors will receive $10 for every share that they own in that company. That would be the investor's cash dividend. These payments are not automatic or guaranteed. That is, if the company did not make a profit, or a large enough profit to distribute to stockholders, then stockholders receive no dividend and the company is not in anyway in default. This is true for both common and preferred stocks, as well as high-quality and low-quality stocks.

The second way that investors make money investing in stocks is through capital gains. Capital gains are the profits made from an increase in the market value of the securities. Capital gain works like this. If you bought 100 shares of Company A stock at $50 per share, and the price of the stock increased to $55 per share, then you made

$500, it’s that simple. For the most part, the risk (or fall) of a stock’s market value reflects the direct relationship between a company’s performance and an investor’s desire to own the stock. When investor’s believe that a company is developing well or in good position to do so, they buy the stock, hoping that the price will increase over time. An increase in the market value of a security (capital gain) is also called capital appreciation. The combination of the dividend income and the capital appreciation made on an investment constitutes your total return.

How do I get started investing in the stock market?

If you want to start investing in the stock market, we recommend the first thing you do is educate yourself about the market and how it works. We can not stress the importance of education enough when you are just starting investing. Although the stock market seems to relentlessly make anyone a profit, people still lose money because they don't understand what they are doing. When most people invest in the stock market they are putting their retirement savings or money they have saved for their children's' education into a world they do not understand. Retirement saving and education are not matters to be taken lightly. The 200-level stock courses that will soon be available through Learn Investing will teach you everything you need to know about investing in the stock market. Our 300, 400 and 500-level classes will then help you develop your investment strategies you need to make the most of your money and out-perform the market. If, however, you decide not to take our courses we recommend you get all of the education you possibly can before you jump into the stock market.

NYSE, NASDAQ. . . What are all of these exchanges?

A stock exchange is a place where buyers and sellers of stock meet to transact shares of stock. Think of a stock exchange as being a lot like an auction. Shareholders with stock to sell offer their stock for sale at a certain price. If there is a buyer willing to pay that price, then the sale is made. However, a stock exchange is not necessarily a physical place, it can also be a computer system. There are two major stock exchanges in the United States, New York Stock Exchange (NYSE), and the National Association of Securities Dealers Automated Quotations (NASDAQ).

The NYSE is the oldest (since 1792) and largest stock exchange in the U.S., located at 11 Wall Street in New York City. The New York Stock Exchange (NYSE) is the world's largest equities market, with a total market capitalization of more than $12 trillion. It provides the most liquid, visible forum for the trading of securities worldwide. The NYSE also offers the fairest and most open pricing through its competitive agency-auction market. Essentially this means that trading at the NYSE takes place by open bids and offers by exchange members (brokers), acting as agents for institutions or individual investors. Buy and sell orders meet directly on the trading floor, and prices are determined by the interplay of supply and demand. The NYSE is famous for the powerful American firms that trade their stock on the floor such as General Motors, Merck Co., Inc, and the Walt Disney Company.

The National Association of Securities Dealers Automated Quotation (NASDAQ) Stock Market is the largest electronic, screen-based market in the world. This means that the

NASDAQ is not an exchange like the NYSE. It has no trading floor, brokers, or runners; instead orders (buy and sell) are handled exclusively on a computer system. The NASDAQ has the capacity to handle share volume in excess of one billion shares a day. Share volume is the number of shares of stock that are bought and sold during a single day. Known for its innovative, leading-edge growth companies, the NASDAQ has two tiers: the NASDAQ National Market, with NASDAQ 's larger companies whose securities are the most actively traded, and the NASDAQ SmallCap Market, with emerging growth companies. The NASDAQ trades such new and competitive technology firms as 3Com Corporation, Biogen, Intel and Microsoft.

Dow Jones, S&P 500… What are all these Indexes?

Stock indexes such as the Dow Jones Industrial Average (DJIA), the New York Stock Exchange Composite (NYSE Comp.), the Standard & Poor's 500 (S&P 500), and the NASDAQ-100 are measures of the performance of a certain aspect of a stock market. These indexes are generally based on the performance of selected stocks within an exchange specifically chosen to assess some sector of the market or the health of the economy. Contrary to popular belief, the performance of a given stock index is not necessarily reflective of the performance of the stock market as a whole. Often, stocks that make up an index are chosen such that their performance judges the health of a specific sector of the market or economy, not the stock market overall.

The Dow Jones Industrial Average

The Dow Jones Industrial Average (DJIA) is a market index used to measure the performance of the United States financial markets by analyzing the stock of some of the largest and most profitable corporations in the country. It is the oldest stock price measure in continuous use dating back to before the turn of the century when there were only 12 stocks taken into consideration. The Dow Average is a price-weighted index. This means that the stocks that compose the DJIA are accorded relative importance based on their prices. Consequently, higher-priced stocks have a greater percentage impact on the index than lower-priced stocks. The thirty stocks on the Dow today are all listed on the NYSE (New York Stock Exchange) and are all large blue-chip companies that reflect the health of the United States economy. Most firms on the DJIA also have major business operations throughout the rest of the world, thus the index provides some insight into the global economy. The stocks on the Dow are continually updated to reflect changes in corporate America. Some observers, however, believe that the DJIA is not representative of the overall market. Primary among their reasons is that the component stocks represent less than 15% of the market value of the stocks traded on the New York Stock Exchange. As a result, two broader market indexes have gained favor as more reliable indicators: the Standard & Poor's 500 Composite Stock Price Index and the Wilshire 5000 Index. Some stocks included in the DJIA average are International Paper, Co., Boeing Co., and Eastman Kodak Co.

The New York Stock Exchange Composite

The New York Stock Exchange Composite Index (NYSE Comp) reflects the general trend of stock price movements of common stock on the New York Stock Exchange. There are four subgroups to the NYSE Composite: industrial, transportation, utilities,

and finance. Stocks of firms classified in each of these categories are measured with similar stocks such that the performance of that aspect of the economy can be examined. These indexes are basically a measure of the value of the NYSE common stocks adjusted to eliminate the effects of capitalization changes, new listings and delistings. Capitalization changes (changes in the assets owned by a firm), new listings (new firms added to the NYSE), and delistings (firms removed from the NYSE) affect the composite index, but are not reflective of the constant performance of the stocks included in the index.

Standard and Poor's 500

The Standard and Poor's 500 (S&P 500), is a capitalization weighted index of 500 stocks. Capitalization weighted is the term used to describe the practice of taking into account firms on the index with a larger capital stock more than firms with a smaller capital stock. It is used to measure the performance of the entire United States stock market. The S&P 500 index represents the price trend movements of the major common stocks of United States publicly traded companies. The S&P 500 Index covers about 69% of the value of the U.S. stock market and is dominated by large companies. It is composed of 380 industrial, 37 utility, 73 financial and 10 transportation issues. Although less popular than the DJIA, the S&P 500 is often used as a more accurate measure of the performance of the United States economy because the stocks included in the index allow for more diversification. In recent years, the performance of the S&P 500 has become even more important because many investors believe that the numerous technology and service industry oriented stocks on the S&P 500 represent the current economy better than do the industrial stocks on the DJIA.

The NASDAQ-100

The NASDAQ-100 Index includes 100 of the largest non-financial, U.S. (and for the first time starting in 1998) non-U.S. companies listed on the National Market tier of The NASDAQ Stock Market. The Index reflects NASDAQ 's largest growth companies across major industry groups, including major players in high technology, airlines, department stores, retail, and healthcare. All firms included in the index have a minimum market capitalization of $500 million, and an average daily trading volume of at least 100,000 shares. Almost all companies in the index are over $1 billion in market value; $6 billion is the average. In addition companies must have been listed on NASDAQ for a minimum of 2 years before they can be measured for the index by other quantitative standards. Some stocks included in the NASDAQ-100 are Sun Microsystems, Inc. and Netscape Communications Corporation.

Other Indexes

Two more indexes worth mentioning are the Wilshire 5000 and the Russell 2000. The Wilshire 5000 Index includes all securities regularly traded on the New York and American stock exchanges as well as in the Nasdaq Over-the-Counter Market. The Wilshire 5000 is actually composed of more than 7,000 securities and is arguably the "all-market" measure for U.S. stocks. The Russell 2000, on the other hand, is designed to be a comprehensive representation of the U.S. Small-Cap equities market. That is, the Russell 2000 is the usual standard used for U.S. small company stocks. The 2000

companies comprising the index have a market value ranging from $58 million to $600 million.

What kind of risk is associated with investing in the stock market?

Any investment, whether it is in bonds, cash reserves, futures contracts, options or stocks, involves some degree of risk. Economists are famous for saying that the only truly safe place to put your money is under a mattress. Simply defined, risk is the possibility that you will lose your money or that you will not make money. A major factor in determining where an investor should allocate income is how much risk the investor is willing and able to handle. Younger investors and investors with a steady, more than sufficient income can generally accept more risk. Older investors, close to retirement age or investors on a limited income cannot be as tolerant of a significant amount of risk. Stocks typically offer high returns, but they expose an investor to a high level of risk. There are five basic classes of risk associated with investing in the stock market: income volatility, market risk, currency risk, country risk and inflation risk.

Income Volatility
Income volatility risk is the possibility that the dividend yields on a share of stock will fluctuate significantly. When an investor buys shares of common stock he/she is buying a share of ownership in a firm with the hope to share in the firm's profits, often in the form of dividends. The investor no longer has the option to spend the money invested in the stock or invest it elsewhere to earn income. Therefore, if the firm has a poor year and the dividend yield on the stock is little to nothing; the investor has sacrificed some of the money invested in that stock because the risk did not pay off. Dividend yields can also fluctuate when the stock market and firms are doing well. Many investors and stock experts feel that numerous common stocks may currently be over-priced. They point to the fact that the dividend yield of the S&P 500 has fallen to 2.0% as of December 31, 1996, well below the 3.8% average yield for the previous 25 years.

Market Risk
Market risk is the risk associated with fluctuations in stock prices. It is the risk that most people associate with stock market investing. Many factors can cause stock prices to fluctuate. Examples include: actual or anticipated developments within a particular company or industry; changes in the outlook for the economy as a whole; or shifts in investor attitudes toward the stock market in general. Downwards and upwards trends in stock prices can occur over short or extended periods, and can therefore have a very significant affect on the value of a share of stock. A downward trend in the price of a stock over a period of time, known as a bear market, can lead to an investor losing a significant amount of their principal. Older investors or investors with fixed incomes who have retirement accounts (usually IRAs or Roth IRAs) invested in the stock market face a very significant market risk. Take for example a 55-year-old investor with an IRA invested in an aggressive growth mutual fund. A bear market at this age could be devastating to the investor's retirement savings. His/her retirement savings could be slashed in half in just a few months, and unlike the young investor he/she doesn't have the time to ride out such fluctuations or re-make the money. Even the lack of movement

of the price of a stock over a long period of time can be devastating to an investor. If the stock does not increase in price, inflation will erode the principal.

Currency Risk

Currency risk is the risk associated with price fluctuations in the dollar value of international stocks due to changing currency exchange rates. To an American, the value of any stock held internationally is not what the stock is worth in its domestic market, but what the stock is worth in terms of dollars. American investors are only concerned with the value of the stock in dollars because Americans can only purchase goods with dollars. Therefore, regardless of the risk associated with investing in a stock domestically or abroad, an investor must recognize the risk associated with changes in the exchange rate between the U.S. dollar and the currency of the country in which they own stock. When the exchange rate falls with respect to a given foreign currency, the U.S. dollar is said to appreciate and the other currency depreciates. The appreciation of the dollar with respect to a foreign currency means that it will cost more of the foreign currency to obtain each dollar. Therefore, the appreciation of the dollar will erode the value of a foreign stock while the depreciation of the dollar will increase the value.

Country Risk

Country risk is the risk of price fluctuations of stock held abroad due to political and financial events that happen in those countries. Just as in the United States, expectations have a significant affect on the prices of stocks traded in markets overseas. Therefore, events that investors believe will have a significant affect on the market or the ability of firms to return profits will affect prices of stocks. Such events can vary from movement to a state-controlled economy to passing laws that increase taxes on firms. Developing countries and countries in which the political situation is unstable carry far more investment risk than do stable countries with developed economies. For example, investing in former Soviet republics and African countries would involve a significant amount of country risk. On the other hand, investing in Western Europe and Canada does not involve much more risk than investing in the United States.

Inflation Risk

Inflation, defined as a persistent increase in prices, has a corrosive effect on investments. Historically inflation in the United States has averaged 3.1%, offsetting most of the returns from investments in cash reserves and bonds, but less than half that of stocks. Because stock's real returns are much higher than inflation, stocks are referred to as "inflation hedge"- or a way to protect money against inflation. However, historic stock returns are merely an average and stock prices have fluctuated significantly over the past century. Investors must be aware that during times of high inflation, such as during the 1970's, increases in the price level wipe out or erode the profits made in stock market investments. For example, suppose that inflation during a given year was 6%, that is prices increased 6 cents for every dollar during that year. If the nominal return on an investment, the return on the investment before adjustments for inflation, was 4%, then the investor actually lost money, 2 cents for every dollar invested. However, if the return on an investment was 12%, then the investor made money and had a 6% return rate for the year.

Introduction to Course 201…How to Read Stock Charts

Thanks for taking Learn Investing 200 Level Stock Courses. In this course you will learn just about everything there is to know about stock price charts. We are going to start off with the basics like The Parts of the Charts and what each tick represents on the data lines. If this confuses you right now then do not worry. In the next section, Open, High, Low and Close (OHLC) Exposed we will explain everything. Right now though, I just wanted to point out a few features of this course to you. Whenever we make a reference to another topic in this course, or any other 200 level stock course, we will put a link to it. It will be a different color, probably blue, and it will be underlined. That means if you want to go back and review this topic you can click on the hyperlink, the underlined blue word, and it will take you directly to that lesson. This makes it very easy to go back and refresh what you just learned or to jump ahead and catch a glimpse of something that particularly interests you.

You can also move to the next lesson or the previous lesson by clicking on the appropriate link at the bottom of each page. This will allow you to read the entire course straight through. I recommend that you read through the course straight through on your first reading to get an overview of everything that you will learn. Then go back and read it again. The second time read it for mastery.

Open, High, Low and Close (OHLC) Exposed

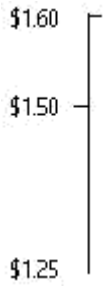
I am going to show you how price data is charted on a price chart. Let us imagine we are shopping for a loaf of bread. We are going to get price quotes, often called just quotes, on how much one load of Skippy Brand bread will cost us. We are going to call different stores to find the price of this load of bread.

So I call up store #1 and I ask, how much is a loaf of Skippy Branch bread? They tell me that it is $1.50. Since this is the first price quote that I got, let us call this the Open. It is the price that bread opened at today.

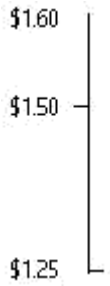
My second call is to store #2. They tell me that a loaf of Skippy Brand bread is $1.25. Since this is the lowest price of the day it is called…

you guessed it, the Low. The Open is still the quote we got from store #1 and will be no matter what because it was the first quote we received.

In the diagram above we can see by looking at the long vertical line (the one that goes up and down) that the price of bread has been as high as $1.50 and as low as $1.25. The small horizontal lines that resemble stubby branches off the vertical line represent the Open and the Close (or current price). The stubby branch that sticks out to the left is always the Open. The stubby branch that sticks out to the right is the Close or current price.
When I call up store #3 and get a quote on Skippy Brand bread I get $1.60 per loaf. So our picture changes to look like the one shown below.

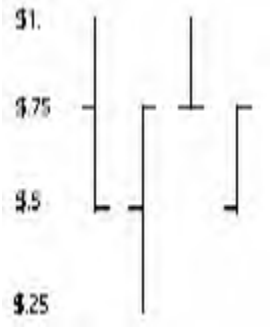


In the diagram above we can see that the price for a loaf of bread has been as low as $1.25 and as high as $1.60. We can tell this because the vertical line goes from $1.25 to $1.60. The little branch that sticks out to the left and points to $1.50 is the Open. The branch that points to the right is the Close or the current price of a loaf. In this case it happens to be $1.60.
Now, when we call store #4 we find that the price changes the chart so that it looks like this:



More OHLC Exposed

Now that we understand the basics of Open, High, Low and Close and how they are represented on a price chart of a single day's prices, we are going to get a little more advanced and show you a few day's worth of price data. In the chart below we are showing you the price of oranges per pound.



Now let us analyze the chart above and see if we can interpret what is going on there. The first thing to notice is that there are 4 vertical lines. Since this is a chart of the *daily* price of oranges we can say that for each vertical line there is a whole day's worth of price data. So 4 vertical lines mean there are four days worth of data.

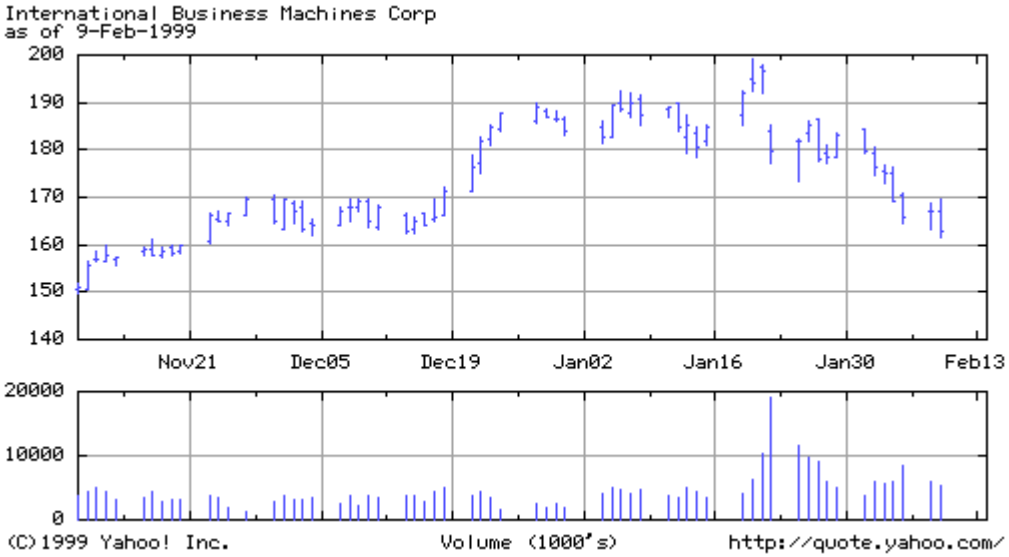
The first day's data is the vertical line farthest to the left. The most recent day's data is the one farthest to the right. Let us analyze the data day by day starting with day one. On day one the price opened at $.75. We can tell this because the left tick (that is the stubby branch that sticks out left on the left most vertical line) is at $.75. During the course of the day the price of oranges per pound varied from $1 per pound all the way down to $.50 per pound. It closed at $.50 per pound on day one. We can tell it closed at this amount because of the right tick mark on the first vertical line. On the second day the price of oranges opened at $.50. Again we can tell this because of the left tick mark which denotes the opening price. Now here is an important concept: the price does not have to open at what it closed at the day before. In this particular case from day one to day two it just happens that the closing price of day one is the same as the opening price of day two, but it does not have to be this way. For instance, let us look back on our bread-pricing example. What happens if our last quote on bread was $1.25 on one day and we stopped pricing bread until the next day? On the next day we started pricing bread again and our first price quote was $1.50. In this case the close of the previous day, $1.25, was not the same as the open of the next, $1.50.

Let us get back to our current example of orange prices. In the chart above we can see that the price of oranges on day two ranges from $.25 to $.75 and it closed at $.75.

On day three it opened at $.75 and went as high as $1.00 per pound but then closed at $.75. During the day we never had a price quote on oranges that was below $.75 because the lowest that the vertical line goes is to the $.75 mark.

The Parts of the Charts

Congratulations on completing topic one: Open, High, Low, & Close (OHLC) Exposed. You will have an opportunity to use the knowledge you gained in The Parts of the Charts. This topic is where you will see a few charts of real stock prices and we will teach you what each part of the chart is. You have already started gaining the knowledge that is necessary to becoming a successful stock investor. Continue educating yourself as we go over the Parts of the Charts.
Here is a chart of a company called International Business Machines. They often go by a shorter name, IBM. IBM is also their ticker symbol.



At first glance this chart may look intimidating, but do not worry. We will break it down, and you will see that is constructed of parts that you already learned about.
The above chart is actually a chart of the daily prices of IBM stock over the duration of about 3 months. That means that each blue line represents one day's worth of price data and that there are about 90 days worth of data here (30 days in a month times 3). There aren't actually 90 blue lines however, since IBM stock only trades during the work week and not on weekends.
We can take the data we have in 5 days of data and combine it into one blue line. These types of charts where one whole week's worth of data is represented as a single bar is called a weekly chart. We can also just plot the closing price of each day as a single point and draw a line by connecting the closing price dots. Below is an example of a weekly chart of IBM that just plots the closing price as a dot and connects the dots.

As you can see in the chart above, we can show a far greater period of time on the chart when we just plot the closing price. This is often helpful when trying to determine what the price has been doing over a longer period of time.

Look up at the chart again. There is some additional information that I want to point out. In A few words on volume we will talk about how we use volume to determine whether or not we should consider trading a particular stock, but for now I want you to notice where the volume figures are located. Below the main price portion of the chart, you can see numerous blue vertical bars, these are the volume figures. Each bar represents the volume for that particular period: day, week or month depending on the type of chart. You should also notice that the Volume is in 1000's. We can see this by the writing on the bottom center of the chart.

The last thing you should note in the charts above is the difference in scales for the stock price data. In the top chart, the scale is linear. What does a linear scale have to do with anything? Not much. It is just different from a logarithmic scale which is what the second charts uses.
You may be asking, why did you point the different scales out to me then? I pointed it out to you so that you can realize that even though the bottom chart looks like it isn't growing as fast near January 1999 it is actually growing faster because we are looking at it on a logarithmic scale. Notice in the bottom chart that the distance between 80 and 100 is much larger than the distance between 180 and 200 even though they both represent the same $20 value in stock price change. This is a result of using a logarithmic scale. Linear scales use equal distances. Logarithmic scales has different distances and distort the picture slightly.
What advantage does a logarithmic scale have over a linear scale? Usually, it means you can fit more data in a smaller space. The difference in scales is really not a very important concept to understand, since for the majority of charts, you can get them in linear scales. However, you should note the scales when comparing two different charts so that you are sure you are comparing apples to apples and not apples to oranges.

A Few Words on Volume

You may watch a financial news station and hear that a certain stock is down on low volume today or is up on high volume today. What does volume have to do with the price of a stock and whether or not I would like to trade it? But first, what is volume? Volume is the number of shares traded during the time period. If we are talking about today's volume then it is the number of shares traded, that is bought or sold, today. If we are talking about last week's volume then it is the number of shares that traded during last week.

There are a few issues to discuss concerning the volume of a stock. The first issue is what effect does volume have on considering whether or not to enter a trade. Assume that you are considering buying stock in IBM. Since IBM has a fair number of shares outstanding the possibility of being able to buy 100 shares of IBM is pretty good. You will probably, within a day or two or more likely even sooner, be able to find someone who is willing to sell you 100 shares of IBM. However, assume you are looking to trade a much smaller company that only has 10,000 shares outstanding. Depending on how people feel about that stock, they may not be looking to sell their shares and so it may be difficult for you to buy 100 shares. By looking at the trading volume you can gauge how many shares trade each day.

Furthermore, the more shares of a stock that trades during the day the more liquid the market. What is market liquidity? The easier it is the buy and sells a stock the more liquid a market is. Lack of liquidity can adversely affect the price at which you buy or sell. If a market is not very liquid and you place a market order to buy a stock then you may get filled at a price much higher than what you expected to get filled at. We will cover types of orders later in another course, but for now realize that there are ways to curb this potential problem using certain types of orders.

Calculating Change

This is the exciting part of the course: where we determine how to calculate our profits. Let's revisit the chart of IBM stock that we saw in Parts of the Charts.

http://images/calcul1.jpg

In the chart above, we can see the different dates labeled along the bottom of the chart. The 99 to the far left refers to the year, 1999. The 11, 18 and 25 refer

to days; specifically January 11, 18 and 25. The "F" signifies that that is the start of February.

Assume that we entered the market on January 18th at $182 per share. I have drawn in a red down arrow to show this day. Let us also assume that we bought 10 shares. That means, we paid the following:

$182 per share times 10 shares = $1,820

On the 21st of January (blue up arrow on the chart above) we decide to exit our position and sell our 10 shares at $195 per share. How much did we make? Well, the math is quite easy.

First we take the price that we initially bought at, $182 per share, and subtract it from the price that we sold at, $195 per share.

$195 per share - $182 per share = $13 per share profit

Then we multiply our dollar profit per share by the number of shares that we bought and sold. In this case, we bought and then sold 10 shares.

$13 per share times 10 shares = $130 profit.

That is how easy it is to calculate changes in value of a stock.

Finding and Using Charts

Congratulations on finishing most of Stock Course 201 on chart reading. You are just about ready to move onto learning some real stock strategies. This is where the real excitement begins, but before you move onto the more interesting material there are a couple more things that you should know about stock charts. The most important thing you should know about stock price charts is where to find them.
On the World Wide Web there are over a hundred places that you could find a chart of price data. Search engines like Yahoo can give you a price chart of most stocks. The exchanges that trade these stocks can also give you a price chart. Brokerage firms can give you stock price charts. These are your primary places to find price charts.
There are commercial products available that will allow you to pull prices off the Internet and directly onto your computer to chart price data. Even some of the latest personal finance software packages will automatically retrieve current price data from the Internet and update the value of your investments in your electronic account book.

Which ones should I use?

This is a question that we often get at Learn Investing and our answer is always the same. What do you have access to and feel comfortable using? If you have access to the World Wide Web and you like using Yahoo then just use Yahoo. If you prefer to use your broker’s page then use that. It is a matter of personal preference more than anything else.

Introduction to Course 202… Stock Strategies

Welcome to Learn Investing Stock Course 202: Stock Strategies. In the previous course you learned all about price charts. You are know ready to start learning about some of the strategies we use to invest in stocks.

For starters, we will cover the traditional buy and hold strategy. Spinning off from the buy and hold strategy, we will cover different types of averaging systems including: dollar cost averaging, constant dollar averaging and constant ratio plans. After these more traditional ways of investing, we will go into different methods of choosing which stock to invest in by comparing and contrasting technical analysis to fundamental analysis.

After discussing what is similar and what differs between Technical and Fundamental Analysis, we will go over some ways that you can use both. First, we will cover the use of technical chart patterns for buying and selling stock, then we will move onto buying and selling based on fundamentals. We will wrap up this course by revealing the secret to picking stocks!

Buy and Hold

The duration that investors hold onto their stock varies immensely. Some traders hold onto stock for only minutes, trying to capitalize on the small moves that stocks make during the day. These traders, often called day traders, can make or lose thousands of dollars on changes as small as 1/8 of a dollar per share. On the other hand, some investors buy a stock when they are 18 years old and pass it on to their grandchildren after they retire. Most people fall somewhere in the middle of those two extremes.
The goal behind the buy and hold strategy is for you to buy the stock at a price, let us say, $10 per share of stock, and for the price to go up during the time that you own it. If the price moves up $5 per share then you have realized 50% return on your money. For example, if you bought 100 shares of a stock at $10 per share and the price per share increased by $5 to $15 per share. Then you made $500. Let us examine how we calculated this:
100 shares times $10 per share = $1000 invested initially
Price increases by $5 per share therefore each share is now worth $15 each
100 shares times $15 per share = $1500 (the value of your 100 shares now)
$1500 (the current value) - $1000 (the initial value) = $500 profit
You can make money buying a stock and holding it in other ways besides waiting for the value of the stock to increase. Some companies, usually when they show a profit for the year, may elect to pay you a dividend based on the number of shares of their stock that you own. A dividend is money from the company's profits that the company pays you for investing in them. This is another way that you can make money by investing in stocks. By simply owning the stocks, the company will pay you part of their profits. Some companies will allow you to take the money they distribute as dividends and automatically buy more shares of their stock with it. For instance, let's say we are looking at the Digicom Systems stock and it is trading at $10 per share. They decide to pay a dividend of $1 per share to every shareholder. Assume you own 100 shares of DSI stock, you would then be eligible for $100 in dividends. Instead of taking the dividend, you decide to participate in our dividend reinvestment program and choose 10 more shares of DSI stock. Now you own 110 shares of DSI stock.

Averaging

Have you ever bought something and a week later the price went down? Ever wished that you could go back and buy it at the lower price? Well, with stocks, although we can not go back and get the lower price for all of the stocks that we already bought, we can lower the average price that we paid for the stocks. We do this by averaging down our purchase price. Here is how it works.

Assume we bought 100 shares of stock at $10 per share. We invested a total of $1000 and our average price is $10 per share ($1000/100 shares = $10 per share). A month goes by and we find the price of each share to be $8 per share. We decide to buy 100 more shares for $800. Now, we paid a total of $1800 and own 200 shares. That makes our average price $9 per share ($1800/200 = $9). This is known as averaging our price down.

Dollar Cost Averaging

Dollar cost averaging is an investment strategy we use to ensure that we buy more stock when it is cheaper. Let me explain.

Assume that we want to buy stock at a regular interval. For our example we will choose to invest $100 every month. At the beginning, the value of the stock we are looking to buy is at $10 per share. At $10 per share, we can afford to buy 10 shares.

The next month comes along. We have 10 shares that we bought for $10 per share. But the price of the stock just dropped to $5 per share. We buy $100 worth of stock again, but this time we can buy 20 shares for our $100. That leaves us, at the beginning of the second month, with 30 shares of stock. Our average price per share is $6.67 ($200 invested/30 shares = $6.67 per share).

The next month approaches and the price of the stock drops down further to $2.50 per share. We buy $100 more of the stock. At $2.50 per share, we can buy 40 shares. This would give us a total of 70 shares on an investment of $300. Our average price per share is: $4.29 ($300 invested/70 shares = $4.29 per share).

This might seem very similar to averaging your price down, and it is. The only difference is what happens when the price goes up. Notice that in our example, the lower the price goes, the more shares that we can and do buy. Assume that the next month the price of the stock skyrockets and goes up to $20 per share.

At $20 per share we can afford to buy 5 shares. This brings our total investment up to $400 and our number of shares up to 75. That makes our average cost per share: $5.33 and our profit so far $1,100.

With this system of managing your money, you buy more when the stock is cheap and less when the stock is expensive. If you can combine this with a sound system of when to sell for a profit, this system works great!

Constant Dollar Averaging

We started with the most simple, Buy and Hold strategy and then moved on to the concept of averaging the price we paid for a stock. After discussing what averaging does for us, we covered Dollar Cost Averaging, a very rigid means of managing your investments and deciding when and how much to buy. The next type of investment strategy is a bit more complicated. It is called Constant Dollar Averaging. The following is an example of how it works.

Greg is an investor with a $10,000 portfolio of his investments. He has decided that he wants to keep $1,000 of his portfolio in the utilities sector. He specifically likes the stock of one Electrical Power Company, we will call it The Electric Corporation, symbol TEC. The price of TEC stock is $10 per share when he first starts investing in it. Since TEC stock is $10 per share he can buy 100 shares ($1,000/$10 per share = 100 shares). With Constant Dollar Averaging, Greg wants to keep the same dollar amount of the stock constant. In other words, he always wants to have $1,000 of his money invested in TEC.

Therefore, if suddenly the price of TEC stock rises to $20 per share the value of his shares of TEC stock is now $2,000 (100 shares times $20 per share = $2,000). In order to maintain a Constant Dollar Amount, Greg would sell $1,000 worth of his stock.

Now, I question that often comes up here is, "How often should I keep track of this?" The answer depends on you. If you want to keep a Constant Dollar amount of a certain stock and you only want to check on it once a month, then you would do it monthly. If you are in and out of the market more frequently, then perhaps you should do it weekly or even daily.

You should also consider that you will not be too concerned if the value of TEC stock is $1,010 and not exactly $1,000. You will need to find your own thresholds for how close to $1,000 do I really intend on keeping my portfolio.

Constant Ratio Plan

In the last topic we talked about Constant Dollar Averaging. Remember, in that plan we wanted to keep a fixed dollar amount of our portfolio invested in one stock. For example, if we had a $20,000 portfolio we might want to keep $2,000 of it in, let's say Microsoft stock. With Constant Ratio Plan investing we do not intend to keep a fixed dollar amount of a stock, we intend to keep a fixed ratio or percentage. Let me explain. Using the same information above, a $20,000 portfolio, we could say, using the Constant Ratio Plan, that I want to keep 10% of my portfolio invested in Microsoft stock. That means that I would want 10% of my $20,000 invested in Microsoft. That would be $2,000.

However, if the value of my entire portfolio (whether it was due to Microsoft stock or anything else in my portfolio that I may also be investing in) goes up to $25,000, then I would want to increase my stake in Microsoft to $2,500. Similarly, if the value of my portfolio were to decline for whatever reason, I would want to ensure that I still had 10% of my portfolio's value in Microsoft.

Technical Analysis versus Fundamental Analysis

In the last few topics, we covered a few of the ways that you can use to manage your investments in a portfolio, but how do we pick a stock to begin with? There are two major ways to do this: Fundamental Analysis and Technical Analysis.

Thousands of books have been written on each. Different folks will tell you which they prefer, but it comes down to which one you believe will give you the best stock. And if you can't pick one over the other, you can classify yourself as one of the many hybrids who believe that both have their merits and use a combination of both. What is the difference between Technical Analysis and Fundamental Analysis?

Simply stated, Technical Analysis is the study of price charts to determine whether or not to buy or sell a stock. Fundamental Analysis is the study of "fundamentals" to determine whether or not to buy or sell a stock. "Great!" you say, "What are fundamentals though?" Fundamentals include anything that affects the price of a stock:

- How is the management of the company?
- What are the expected earnings of the company?
- What are other similar businesses doing?
- What is the current value of stock in relation to its current earnings?
- Is the company going to buy out another company?

These are all examples of fundamentals, but in no way does this complete the list. The list is endless and this is one of the arguments of that Technical Analysts have against Fundamental Analysts. Technical Analysts claim that there is too much information to cover and they point to studies showing that the more information that someone is given, the more likely they are to pay attention to less significant data and make poor decisions based on the less significant data. Technical Analysts claim that all of the fundamental information is accurately represented in the price chart of a stock.

For instance, if the management of a company is poor, that is already going to be accounted for in the price of the stock (that is the price of the stock will be low for that reason). If the company has poor earnings, then the value of the stock will also be low. All of the fundamentals that affect price are already doing so and that makes the price chart the most accurate reflection of a stocks health, so claim the Technical Analysts.

I personally believe that a little common sense, and the use of both Technical Analysis and Fundamental Analysis can go a long way. In the next topics, we will cover some of the basic approaches that Technical Analysts and Fundamental Analysts use. So, keep on with your stock market education, cause we are about to learn The Secret to Picking Stocks.

Technical Analysis... the Basics

Technical Analysis great advantage is that it eliminates the need for you to become an expert in hundreds of specific fields. All a purely technical investor has to do is become an expert at technical analysis. Once you become an expert at technical analysis, analyzing technology stocks, blue chip stocks, small cap stocks or any other type of stock is essentially the same. You simply apply the technical tools that you have learned to use to the stock's price chart and you are ready to pick a winner. But, what are some of the tools that technical analysts use?
As a technical analyst you will look at stock price charts, like the one below.

In the chart above, a technical analyst would, as an example, draw in the red lines to show that the stock price is forming a wedge. Using certain rules, like the ones we teach in our technical analysis of stocks course, the technical analyst would be able to predict whether to buy or sell the stock. This is a particularly simple example of using technical analysis, but technical analysis can be very complex and include the use of moving averages, stochastics and bollinger bands, to name a few.

Fundamental Analysis... the Basics

While using technical analysis allows any stock investor to cross over markets and simply apply their technical tools to a stock price chart, sometimes you may want to know some fundamental information about the business or industry that you are investing in. Research, research, research is the key. Plowing through newspapers, magazines and on the Internet is how many people get their information. Others use their brokers to gather "hot leads". I would suggest though, a more thorough approach. There are five major things you should examine when fundamentally studying stocks:

- Price per share
- Price to earnings ratio
- Earnings yield
- Book value
- Dividend yield

Each of the above should be considered when fundamentally analyzing stocks.

Picking the Right Stock... the Secret Revealed!

So which is better, fundamental analysis or technical analysis. The answer... it depends on who you are.
There are investors who are millionaires now because of becoming proficient at technical analysis. The same could be said of fundamental analysis. The secret is to find something that works for you, and to stick with it. The fact that you are investing in the first place is more than half the battle!

Introduction to Course 203 Options… Getting Your Feet Wet

It has been said that options are the most leveraged type of investment that you can own. What does this mean? Welcome to Learn Investing Course 203 on Stock Options. By now you should know some simple stock strategies and the differences between technical and fundamental analysis. You should be able to read a price chart and you should also have a basic understanding of how the stock market works.
In this course, we will go over the advantages of buying options and define some of the jargon we use with options like put, call, strike price and delta. Finally we will cover option strategies that you can use when trading.
Buying stock options is so powerful for two main reasons:

- **Options have completely limited risk and unlimited potential for gain.**
- **Options are extremely leveraged (even more so than trading on margin).**

With this said, let me explain each those statements to show you why options are even better that trading just stocks in many ways.

Limited Risk & Unlimited Gain

Options are the ultimate equalizer. They allow even the most undercapitalized traders to trade like the professionals. When you write options you can never lose more than the cost of the option. Because of this, you can completely limit your risk to a level tolerable by you. So even if the price of the stock went to zero, you would only be out the cost of the option.

Here is an example, assume that you are looking at IBM stock. You want to buy in but the computer industry has been taking severe hits lately and you are reluctant. If you do buy the stock and the value of IBM stock goes to zero, you could be out a substantial amount of money (your whole investment). My realistically, if the price dropped by 50%, you would probably be pretty frightened by the sudden loss of half of the capital you invested in IBM stock. For fear of it dropping even farther and losing all your money, you might liquidate (sell the stock back) at a 50% loss.

With options, you don't have to worry about that as much. For a fraction of the cost of buying the same amount of IBM stock, you can buy an option on IBM stock. An option will allow you to have unlimited profit potential. At the same time, you could never lose more than the price of your option. Remember, you are paying much less for the option than you did for buying the stock, so this could be a great trade-off for you.

If options are so great, why isn't everyone trading them? Well, you give up one thing when you buy options... unlimited time. An option is only good for a limited amount of time: 1 month, 3 months, 6 months, a year, etc. When you buy the stock, you can sit on it for a couple of years if you think it will take that long to appreciate in value. On the other hand, with options, if the stock you have an option on has not gone in your favor during the time that you bought the option for, your option expires and the money you paid for the option is lost.

The Power of Extreme Leverage

Options give you the most leverage for your dollar. You put up the least amount amount of money and still have the potential to make unlimited profits. This is what makes options so awesome. Imagine the following example.

You are looking to buy an option on stock XYZ for let's say $25. The stock is trading at $10 per share and your option's strike price (which we will explain in detail in a later topic) is for $12.50. The option you bought for $25 will control 100 shares of the stock (and we will get into this in the next few topics in more detail as well). If you had to buy 100 shares of XYZ stock you would have to put out $10 times 100, or $1,000. Instead, you buy the option for $25.

If the price of XYZ stock goes down, the most you can lose is the $25 you paid for the option. If the price of XYZ goes up to $15 per share, you stand to make $250 on the option. On the other hand, if you had just bought the stock at $10 per share and sold it at $15 per share you would have profited $500. The difference, however, is in the percentage return. That is, what was your gain compared to your investment or risk.

In the case of buying the option, you spent $25 for the option. You made $250 on the option. Therefore, you risked $25 and made $250. That is a return of 1000% on your investment. If you had bought the stock, you would have had to put up (and risked) $1,000 and you would have made $500. That is a rate of return of 50%. You risked more and the rate of return was less! This is what we mean when we say that options are extremely leveraged: you put up very little money to control a large position and stand to make a great deal.

Now that you understand why you might consider using options, let's start learning about the basic terminology used with options

Option Basics

So far we have talked a little bit about why you might be interested in options but we have never really discussed what an option is. In the next few topics you will be bombarded with words that may be new to you: words like put, call, strike price and premium. In time, these words will become second nature to you. While I am defining what an option is, I will also explain each of the terms that I just mentioned.

An option is the right, but not the obligation, to buy or sell a futures contract at some predetermined price within a certain time period.

The above sentence in bold is the definition of an option, but what exactly does it mean? Well, what it says is when you buy an option you can (although you can not be forced to) buy or sell (depending on the type of option you bought) a futures contract at some predetermined price within the time before your option expires. I realize that this may be confusing at this point, so let us step back and go over an example not related to trading.

Let us imagine that we are oil wildcatters (people who scout out land in hopes of finding an oil reserve). We find a plot of land that we think might have oil beneath it. We approach the owner of the land and we ask him if he would like to sell it. He tells us that his land is worth $100,000 (that is the market value of his land right now) and he will sell it to you for that amount.

Now this is the problem: as oil wildcatters we can not afford to spend $100,000 to buy the land and then check for oil. What happens if we do not find oil? Then we have this land that we have to sell to someone else and we are not in the real estate business. We are oil wildcatters. However, if we ask him if we can test for oil before we buy the land then, he will know that he can charge us a lot more for the property if we find oil. So what do we do?

We ask him for an option on the property! The owner of the land agrees that for $500 we have the option to purchase the property for $100,000 within the next three months. If we decide not to buy the land in the next three months then the property owner keeps the land and the $500 (the $500 is called an option premium). At any time during that three-month period he has assured us that we can buy the land for $100,000. He must sell us the land at $100,000 even if we find oil (or Gold and anything else valuable) on the land. Even if the price of the property suddenly became worth $900,000 he would still have to sell it to us for $100,000 if we wanted to buy and decided to "exercise" our option. The price that we agreed he would sell it to us for is called the strike price. In this case the strike price is $100,000.

What happens if we find something during that three month time period of the option that makes the price of the land go down? We obviously would not "exercise" our option in that case. When we buy options we always have the choice, or the option, to either buy the land for $100,000 or not to buy at all. The owner of the land can not force us to buy it. The maximum amount of money that we can lose is the $500 premium we paid for the option. Yet we can make an unlimited amount of money (if we find oil and the value of the land goes up and up and up).

When we think the price of the object we are buying an option on is going up, then we buy a call option. Since we thought the value of the land was going to go up and we wanted to protect ourselves against the rising price, we bought a call option. When we think the price of the object that we are buying an option on is going down, then we will

buy a put option. We will see an example of buying a put option a bit later. For now just realize that there are two different types of options: one when you expect prices to go up (call options) and one for falling prices (put options).
Now that we have seen an illustrated story let us see how much you picked up. Below are some more formal option definitions.

Basic Option Definitions

Below you will see more formal definitions of some of the terms that we saw in Options Basics, the story about the Oil Wild Catter. We will use these terms all the time when talking about options. You may want to return to this page if you ever feel confused with the terms we will be using with options. There is another page of More Option Definitions that covers other terms like intrinsic value, time value, volatility, delta, in the money, deep out of the money and at the money.

Call Option - A call option is an option that gives the owner of the option the right, but not the obligation, to place himself in a long (buy the stock) position from the strike price. Usually, the buyer of a call option expects the stock to go up in value.

Put Option - A put option is an option that gives the owner of the option the right, but not the obligation, to place himself in a short (sell the stock) position from the strike price. Usually, the buyer of a put option expects the stock to go down in value.

Option Premium - The amount of money paid to purchase an option is called the premium of the option. The premium could also be thought of as the cost of the option. The price of an option changes throughout the trading day and is based on three things. To find out what determines the premium of an option visit What Determines the Price of an Option.

Strike Price - The strike price of an option is the price of the underlying stock that, if we decided to exercise our option, we would be long or short from. For instance, if we have a January 1999 Microsoft 200 call option and we decided to exercise it, we would be long (buy the stock) 100 shares of Microsoft from the price of 200. If the price was above 200, this would be a profitable situation for us and we would exercise our option, but, of course, if the price of Microsoft stock was below 200, we would probably not exercise the option because we would be buying the stock (using our option) at a price that is above what it is really worth.

Here is another example of strike price, this time using a put option. We think that ABC stock is going down. We decide to buy a put March 1999 ABC 100 put option for $50. ABC stock is currently trading at $110 per share. If the price of ABC stock drops to $90 per share, we would probably exercise our put option. Exercising our put option places us short (sells us 100 shares) ABC stock from our strike price of 100. When we exercise that put option, we immediately have a profit of $100 (the strike price of our option and therefore the price we sold the stock at by exercising the put option) - $90 (the current price of the stock) = $10 time 100 shares, that is $1,000.

Expiration Date - The expiration date of an option is the last day that you have the choice to exercise the option or to sell it. If you do not exercise or sell your option by this day, then one of two things will happen. If you are in the money, that is if the price of the contract is above your strike price with a call option or below the strike price with a put option, you will automatically be exercised. This means that the exchange will place you long or short the underlying stock from the strike price.

The second thing that could happen on the expiration date of your option is your option could expire worthless. This would happen if the price of the contract was below the strike price in the case of a call option, or above the strike price in the case of a put option. When this is so, you are said to be out of the money. Click here to see a more formal definition of out of the money.

It is important to understand that you could be automatically exercised if your option expires in the money. Usually, this is a good thing, because it generally means, especially using the strategies that we teach, that you are making money

What Determines the Price of an Option

Now that we have read a story about what an option is and learned some of the jargon of options we are ready to learn what determines the price of one. This will help give us the knowledge we will need to be able to pick out good options for our own trades.

Up until now I have been telling you how great options are and how they are the most powerful tools we have as traders. This is very true, but options can be misused and you could spend a lot of money buying the wrong options. It is important to keep in mind what we are trying to do when we buy an option... we are trying to make money! We need to pick options that are going to increase in value. In order to do this we need to know what determines the value or premium of an option. This is what we will learn about here.

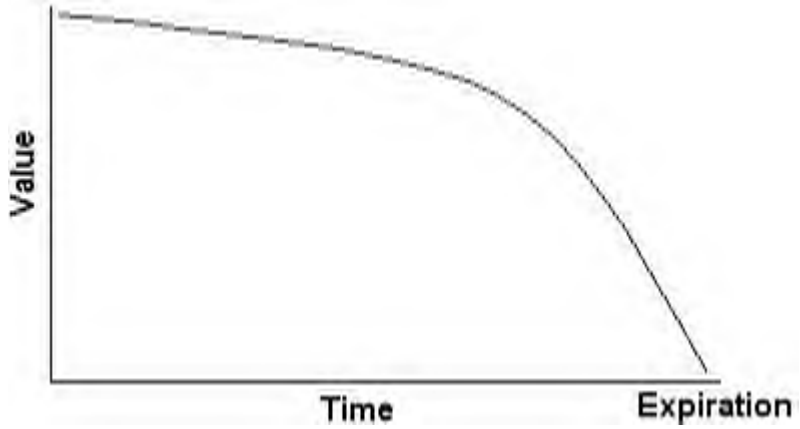
There are three components that make up the value or premium of an option. They are:

1. Time Value
2. Intrinsic Value
3. Market Volatility

Let us go over each one now.

Time Value

The time value of an option depends on how much time remains before the option expires. If an option has a lot of time before it expires then it will be worth more than if it only had a few days before it expired. The time value of an option does not decrease the same amount with each passing day. In fact, the time value of an option does not decrease very much when it has a lot of time before it expires, but as it nears its expiration date the time value drops very fast.
For instance, we have an option on XYZ stock that has $300 worth of time value and 5 months (assume 150 days) remaining before it expires. Its time value may change from $300 to $299.75 when it goes to 149 days remaining until expiration. However, when it gets down to the last two weeks (assume 14 days) remaining, then its value will decay very rapidly. It may go from $145 to $139 when it goes to just 13 days remaining. Below is a graphical representation of this.



Above we can see that earlier in time (left side of the chart) the value of the option is not dropping as quickly as it does when it nears its expiration date. There is an option strategy we teach in the upper level courses that uses the fact that an option's time value will decay quickly toward their expiration to make money. For now we just want you to realize that as an option gets closer to expiration its value is decaying very rapidly. Unless one of the other two contributing factors that determine an option premium, intrinsic value and volatility, is causing your option to increase in value, you should expect to see the value of your option drop rapidly as it nears expiration.

Intrinsic Value

The intrinsic value of the option is its value based solely on how far it is above the strike price if it is a call option or below the strike price if it is a put option. Let us look at an example of a call option.

We have a June 50 ABC call option. That means that we have a call option (we think prices are going up) that expires in June on ABC stock. Our strike price is 50. Let us assume that ABC stock is trading at $55 per share right now. That means that if we decided to exercise the option we would be put long (buy the stock) from $50 and we would instantly have a profit of $55 - $50 or $5 per share. Remember, that options come in blocks of 100 shares of the stock. So, we would have an automatic profit of $500 (100 shares times $5 per share). This value is called the intrinsic value of the option. The option has to be worth at least $500 because if we exercised the option it would be worth $500 in profits. In reality, the option would probably be worth a little more because of the other two things that affect an option's value: time value and volatility.

Now, it is not enough to just include the case where the option is "in the money." That is, the price of the underlying contract is above the strike price in the case of a call option or below the strike price in the case of a put option. We must also consider what intrinsic value or potential intrinsic value is for options that are out of the money. Now this ties in very closely with the next thing that affects the price of an option, volatility. You will learn more about volatility in the next part of this topic. For now, realize that an option that is closer to the strike price is going to cost more than an option that is farther away from the strike price (that is farther out of the money). Options that are deep out of the money have very little potential for intrinsic value and will, therefore, be cheaper than options closer to the strike price. Most of their value will be due to time.

Volatility

Volatility is the most important factor in determining the price of options. What, exactly, is volatility though? Volatility is the measure of how active a market is. If a market is moving up and/or down very quickly, then it is considered volatile. If a market is moving very little each day, then it is considered to be quiet or not volatile. Some markets have "reputations" for being volatile and other have reputations for being quiet or not volatile. When we are trading stocks we want to be careful in volatile markets because we could be caught in a market that is being volatile and moving against us. With options, however, we do not have to worry about this as much. Since we have completely limited risk we know ahead of time exactly what the maximum amount of loss we can have. But, what makes the volatility of the underlying commodity affect the price of an option? If a market is volatile, it is more likely to move. If it is more likely to move, it more likely to move into the money (that is above the strike price if it is a call option or below the strike price if it is a put option). When an option moves into the money, it increases the intrinsic value of an option as we discussed in the topic on Intrinsic Value.

Since there is a greater chance that your option will increase in value due to the volatility of the market, the person selling you the option is going to charge you more for it. That is one way that volatility increases the premium of an option. Here is another way that volatility affects the premium of an option.

When a market is quiet (not volatile) usually fewer people tend to be interested in it. Therefore, there are few people interested in buying options in that market. Since there is little volatility, few people think that the market is going to move. This makes sense... if the market has been moving very little, then what is to say that it is going to move soon? Well, when very few people want to buy something, demand for it is driven down which in turn drives prices down. So, in quiet markets options are usually cheaper. Likewise, if a market suddenly becomes volatile then the demand for options goes up and then, so too does the price for two reasons. The first reason is the reason we stated first... the market is more likely to move because it is more volatile. The second reason is because there are more people interested in buying the options. This is simple supply and demand. As demand goes up, speculators selling options can charge more. People will pay the higher price.

What Determines the Price of an Option Wrap Up

We have learned about three things that help determine the price of an option: time value, intrinsic value and volatility. Volatility is the factor that we will be most concerned with.

Time value, unless you are using the moneymaking strategy that we teach in the course on calendar spreads, is unusable by us. Normally we only consider how much time is left before an option expires when considering buying an option. We do not usually calculate the time value remaining.

Intrinsic value usually does not come into play until the option we bought has gone into the money and we have some intrinsic value to work with.

That leaves volatility to worry about. Now depending on what we are going to do with our options, we may want to wait until volatility becomes very low before buying one.

In the next topic we will formally define some of the terms you learned while we discussed what determines the price of an option.

Stock Option Strategies

The simplest strategy for trading stocks involves buying and then, at a later time and hopefully at a profit, selling the stock. Options can be that simple, you can buy an option, and at a later time sell the option. Again, we intend to sell the option at a profit, which inherently means that you buy the option for some price, let's say $1 and sell it later for $2. In the previous topics, we learned about what determines the price of an option, but now we are going to learn some other strategies that we can use with options that are just slightly more complicated than the traditional buy and sell strategies.

Buying Stock Call Options

This is the bread and butter of options. You think the price of stock ABC is going up. You want to limit your downside risk so you decide to buy and option on ABC. The kind of option you want to buy is called a call option. You hope that you will buy the option at a certain price and then it will increase and you can sell it for a higher price and keep the difference.

You have limited risk when you buy call options. Your risk is the price that you paid for the options. You can not lose more than the price that you paid for the options.

Buying Stock Put Options

Just one tiny bit more complicated than buying call options is buying put options. If you think the price of the stock is going to decline, then you might consider buying a put option. You hope to buy a put option and sell it later for a profit after the stock declines. You have limited risk when you buy put options. Your risk is the price that you paid for the options. You can not lose more than the price that you paid for the options.

Writing Stock Options

When you buy options, someone must be selling them to you. Why would someone want to sell you options? Because there is money to be made trading options. You may hear at some point or another that you shouldn't buy options because... and they'll quote you a statistic or another one similar that claims that most options, some people say as much as 80%, expire worthless. I am not going to dispute or debate their statistics, they may or may not be true. I will tell you that some people make their living writing (selling) options to other investors.

If you can successfully pick a stock that is not going increase or decrease in the next three months or whatever time frame you set, then you can make money writing options. If you sell someone a call option, they want the price of the underlying stock to go up. If it stays where it is or goes down by the time the option is ready to expire, their option is worthless and the person who sold them the option (namely you in this example) gets to keep the amount they paid you.

Writing Naked Stock Call Options

As the title alludes, writing naked call options, can be pretty exciting. The excitement though is due to the fact that you have unlimited risk.

You can lose an unlimited amount of money writing naked call options.

This is like the example we used in the previous topic on writing options. You think that the price of a stock is not going to rise. So you sell someone a call option on the stock. Here is the good side of what can happen: The price of the stock and go down or stay the same. If this happens, you get to keep the premium (remember that that is the price you sold the option for) when the option expires.

Here is the bad side of what can happen: The price of the stock goes up a little above the strike price. The option then expires. Since you were in the money when the option expires, your option automatically places you short 100 shares of the stock. That means you automatically sell 100 shares of the stock from the strike price. This puts you immediately at a loss since the price of the stock is now greater than the strike price. Now, in order to get back to a neutral position you need to buy 100 shares of the stock to offset the 100 shares of stock the you were forced to sell from the option being exercised.

Your gross loss is the difference in the price you were forced to sell at (which is the strike price) and the price you bought the stock at after it was exercised. But wait, you get to keep the option premium so your net loss is the gross loss plus the amount you made by selling the option.

Now, here is the really really bad side of what can happen: The price of the stock can go up and up and up. There is no limit as to how much money you can lose.

This strategy of writing naked calls gives you very limited gain since the only profit that you can possibly keep is the premium amount. This strategy also opens you up to unlimited loss. If the price goes up and up and up, you can be out a large amount of money. There is an alternate that is much safer, it is called writing covered calls.

Writing Covered Stock Call Options

An advantage to writing covered stock call options is that you can profit on a stock you own even when the stock price remains the same. Here is how it works.
Assume you own 500 shares of company whose stock symbol is QWE (this is a fictitious company and is not intended to refer to any real corporation publicly traded). You really like the fundamentals of QWE and think that in the long term this stock is going to go up in value, but for the short term you believe that it will not increase in value substantially. Because you think this, you decide that you are going to write (sell someone else) a call option on your stock QWE.
We call this type of call option a covered call option because you already own the underlying stock. If the person that you sold the option to decides to exercise the option, then you will be forced to sell 100 shares (the number of shares that are in one option) of QWE to the person you sold the option to. The person who bought your option would get to buy the shares at the strike price. You would be selling them at the strike price.
This can actually be a very good deal for you. Let's examine the possibilities. Assume that that you sold only one 110 covered call option and you own 500 shares of QWE which is trading at $100 per share.

- **If the price of the stock goes down from $100 per share to $90 per share...** You lose $10 per share on 500 shares, but you get to keep the value of the option premium that you sold. This premium can be thought of as countering your loss, in a sense making your loss from the stock price drop smaller.
- **If the price of the stock goes up from $100 per share to $110 per share...** You win twice! You get to keep the $10 per share profit on all 500 shares of your stock, plus the premium of the option that you sold. You will almost certainly not have your option exercised if it is just at the money. This is the most ideal situation. You get to keep the option's premium and your stock is making you money.
- **If the price of the stock goes up from $100 per share to $120 per share...** You win some and lose some. You win because the price of the stock that you own has gone up $20 per share. That is $20 per share times 500 shares. But that is not really what you made on the trade. Since the person that you sold the option to decided to exercise the option, you were forced to sell 100 shares at the strike price of 110. That means that you really only profited on 500 shares from $100 per share to $110 per shares and 400 shares from $110 per share to $120 per share. You do, however, get to keep the option premium that you collected from the person you sold the option to.

So, you may be wondering, where is the downside to this trading strategy? Well, the downside is when the price goes up and up and up. When the price climbs without apparent end, you are giving those profits to the person who bought the option. The way to curb this is to only sell covered calls on some of the stock you own like we did above. If we had sold 5 covered call options (500 shares worth) then we would have been taken out of the move to 120. We would only have seen a profit from 100 to 110 and from the option premium. Because of this, we can say that we have limited gain. We still can lose most of our money if the stock price drops to zero, but we are hedging

against a possible drop in price by selling the call options.
This, by the way, is one of my favorite stock strategies.

The Dangers of Writing Stock Options

For our discussion on options thus far we've talked about how great options are. We said they offer limited risk and unlimited gain. If you look back you will see that we made it clear that these things are true only when you buy options.

You do not have limited risk or unlimited gain when you write options!

In fact when you write options (that is sell an option or give someone else an option) you have just the opposite.

When you write (or sell) an option you have limited gain and unlimited risk!

Writing options is just as risky as buying or selling the stock itself because if the person who owns the option decides to exercise the option, then you will automatically be put in the opposite position that they are entering.

Imagine that you just bought an option on IBM stock. You think the price of IBM is going up so you want to buy a call option. Now, imagine that the price of IBM goes up and up and you are now in the money with your option. You decide (at your option, literally) that you want to exercise your option and actually take possession of the shares of IBM stock. Where are those shares coming from?

Well, in the next few topics we will cover some of the different possibilities when we talk about writing naked and covered options. For our example though, let us say that the person who sold you the option actually the 100 shares of IBM stock that he wrote the option for. In that case, when you exercise the option, he or she would give you their 100 shares of IBM stock. That is where they would come from

Introduction to Stock Course 204: Mutual Funds... Using the Safety in Numbers Principle

You now know about stocks and stock options, but what about mutual funds? You may have heard that mutual funds are good investment vehicles, but what exactly are they?

What are mutual funds?

Imagine you and 10 of your friends got together and pooled all your investment money together. Then you elected a person to decide what to buy and when to sell. This is similar to how a mutual fund works. Thousands of people "buy" into the fund by investing so many dollars. You could invest $1000, John could invest $2000, Charlie $500, and so on. A professional fund manager then decides what the fund's money should be used for. The fund's prospectus , which we will discuss in How to Prospectus, describes what the fund manager will be investing in. You make money the same way you make money with stock. If the value of the investments that the fund buys goes up, then the value of your shares of the fund go up. If the investments that the fund invests in goes down, so does your investment in the fund.

How to Read a Mutual Fund Prospectus

Despite the title of this topic, we are not going to go in detail and explain what everything in a mutual fund prospectus is. We are going to give you an idea of some of the things that you should be looking for when reading through a mutual fund prospectus.

When reading the fund prospectus be certain to check on the following:

- What type of mutual fund is it (growth, index, small company...)
- What has the mutual fund's performance been like over the last 3 years, 5 years, 10 years and since inception (since it was started)
- Who is the fund's manager and what are his credentials and track record
- How long has the fund manager been with the mutual fund
- How much is required to start investing in that fund
- How much do I need to buy if I want to buy more later
- Can I have my dividends, interest and capital gains be automatically reinvested
- How much overhead does the fund management require (in other words, how much are the fees the management team takes and what are their operating expenses)
- Are there any other fees (see also load Vs no load mutual fund)

The items above are all things to be considered when deciding on which mutual fund to invest in.

Why Mutual Funds?

By now, you should know what a mutual fund is and have an idea of what to begin looking for in a prospectus, but why mutual funds to begin with? The question is easy to answer. In one word... diversity.

Imagine you took your entire nest egg of $100,000 and invested it in one stock. Let's say stock ABC for example. What if, after you invested in stock ABC, the value of ABC dropped? You had all your nest egg in one basket so to speak and consequently, you probably lost quite a bit of money. Of course, the stock could rally and make a comeback, but it may not. So, how do we remedy this?

We remedy this by investing in five or six stocks or more. The chance of a technology stock (like an internet company) and a blue chip stock (like Coca Cola) and a biotech stock will all go down at the same time. It is unlikely still that they will all stay down if they do go down at the same time. By buying many different stocks, we are diversifying. By diversifying we are spreading out our risk more evenly in the stock market. So what does this have to do with mutual funds?

Mutual funds help us to diversify. By buying $1000 in a mutual fund, we may actually be buying 100 different stocks that make up the fund. So if one or two of the stocks in the fund go down, our loss is very limited in the big scheme of things.

Remember this though, mutual funds are not safer than stocks per se. This is a common misconception. Many mutual funds ARE stocks. What a mutual fund helps you do is to diversify. If the whole market--every type of stock--goes down, a stock mutual funds is not going to protect us. The mutual fund will probably go down too. So, mutual funds are not any "safer" than stocks, but they do help us to diversify the risk.

Reinvesting Dividends With Your Mutual Funds

I hope you had a chance to read the Learn Investing's Eighth Wonder of the World short course. In this course we are going to refer to some ideas from that course as we explain why reinvesting your dividends may be a good idea.

Imagine you had $2,000 in a bank account that earned 10% interest every year. At the end of the first year you would earn $200 interest on that $2,000 ($2,000 * .10 = $200). Now imagine for a minute that you took the $200 in interest out of the bank leaving you with the original $2,000 remaining. At the end of the next year you would have earned $200 again. But, what would have happened if you left the $200 in interest in the bank for the year? Well, it is a pretty amazing thing. Instead of earning interest on $2,000, now you would be earning interest on $2,200. So, instead of earning $200 interest for the year, you would have earned $220 for the year.

An extra $20 may not seem like much, but remember that we keep adding that amount every year by reinvesting our interest. So in the next year, we would have $2,420 ($2,200 + $220). The interest on that is $242 for the year. And it will continue to grow every year like that. Pretty soon, you have doubled your money completely just because you left the money in the account.

The same can be thought about leaving your dividends in a mutual fund. The more money you reinvest in the mutual fund, the more money you will make.

On the other hand some people, especially those retired, will take the dividends and use them to pay for their living expenses, essentially living off their interest. For those of you who are looking to invest for their eventual retirement and not those living their retirement, consider leaving your dividends in the mutual fund to earn even more interest and dividends.

Researching Mutual Funds (Selecting One)

In the Learn Investing's Stock Course 202 we covered in depth how to pick a stock. We talked about using fundamental analysis and technical analysis as vehicles for choosing a stock. In the final topic of Stock Course 202, Picking the Right Stock... The Secret Revealed! we told you the key to picking a profitable stock.
Since mutual funds are usually just a portfolio, or group, of stocks, many of the same tools we used with stock are still valuable when applied to mutual funds. When deciding on a fund, you will want to look at a fund's past performance. You want to inquire who the manager is. How long has the manager been with the fund? If he has only been there 5 years, and the fund has averaged 25% return for the past 15 years. I would look harder at the last 5 years when the current fund manager was in charge.

How do I start selecting a mutual fund?

There are literally hundreds of places that list "The Top 10 Mutual Funds". Start by doing your own research on these. See why the magazine, website or financial advisor is recommending these funds. Is it based on their percent return only? Is it basing it on fundamentals of the fund management team? Don't take someone else's word that this particular fund or that are good investments; do your own research.

Mutual Fund Reports

Morning Star and Value Line put out a reports that rate and profile each mutual fund. The Wall Street Journal usually rates a few mutual funds. Take a trip to the library, grab a copy of the latest personal finance magazine or newspaper that claims it has the best mutual fund picks for right now, and look them up in Morning Star or Value Line and see why they are thought to be best.

Types of Mutual Funds

Once you have delved into finding a mutual fund, you may hear mention of a fund being a growth fund or an index fund or some other type of fund. What are these types and what do they mean? These are the questions we will answer here.

Mutual Fund Classification

Below is a list of some of the different classes of mutual funds with a short description of each.

- **Money Market Mutual Funds -** Fund invests usually in Treasury Bills and other short term interest rate related debt securities.
- **U.S. Government Bond Funds -** Fund invests usually in longer term U.S. Government debt securities.
- **Tax Exempt or Municipal Bond Funds -** Fund invests usually in quality municipal bonds.
- **Balanced Funds** - Fund invests usually to preserve capital by having a balance of stocks and bonds.
- **Income Fund -** Fund invests usually in blue chip stocks that have high dividends.
- **Index Funds -** Fund invests usually in stocks that are part of a major index like Dow Jones Industrial or S&P 500.
- **Growth Funds -** Fund invests usually in stocks that have great potential for capital appreciation.
- **Aggressive Growth Funds -** Fund invests usually in emerging business that are expected to rise rapidly.
- **Global Market Funds -** Fund invests usually in foreign businesses and U.S. business that have a large international market for their products and services.
- **International Funds -** Fund invests usually in foreign businesses.
- **Specialty Funds -** Fund invests usually in a specific, specialized industry or geographical region.
- **Hedge Funds -** Fund invests usually using more speculative strategies.

Introduction to Stock Course 205

By now you have learned about chart reading, stock strategies, stock options and mutual funds. Now you are ready to learn about how you can start researching which stocks to invest in.

Stock research can be both rewarding and draining. It can require extensive amounts of time. Even applying technical analysis is time consuming when you try hundreds of stocks. But the rewards of picking a stock, investing your money in it and watching it profit you is usually worth it.

So without further delay, let us uncover some of the ways that we actually go about researching stocks.

How to Start Researching Your Stock

So you are ready to start researching which stock to invest in. What first? If you are just beginning, start by taking a tip that you heard from a friend or your broker, or even something that caught your attention on the news and do your own research on it. Later in this course, we will talk about companies where you can go to find out lots of data on a potential investment, but some other places to to check for information include your broker, libraries or as we talk about in using the internet to research: visit the companies web site or a major search engine or directory.

Read information about the company, what they expect in the future and what they have done in the past. Remember, you do not have to start off by investing your real money in a stock. You can always practice with "pretend" money for stocks that you think are on the rise.

There are some great companies out there that prepare you for real money trading that can set you up with a mock $100,000 account and access to a live order taker (mock broker). They train you on how to place orders and allow you to get comfortable making trading decisions while you are learning the ropes. Some companies even hold contests with cash prizes to the person who increases the value of their mock account the most during a set time period. I highly recommend using one of these companies.

Using Stock Research Services to Research Your Stock

If you are feeling a little wary about researching your own stocks, there is help available... and some of it is really good help. All over you can find people who are experts at researching stocks, weeding out the not so profitable ones and pin down the winners. Unfortunately, mixed in with the good are some not so accurate researchers.

Want to pick your own stocks, but don't want to dig for data?

If like the excitement of picking a winning stock, but hate pulling up all the data, there is an alternative. Some companies pull together data on thousands of stocks and compile them into standardized reports and this could be extremely helpful to you. In the next topic we will discuss briefly a couple of the more popular ones.

Using the Internet to Research Stocks (Visiting Companies' Web Sites)

So you think you have an idea of what stock you want to invest in. Where else can you find out more information about a potential investment? Try their corporate web site. Many publicly traded companies nowadays realize dually the importance of giving stock holders information about their company and also providing customer/investor information on the World Wide Web.

Companies like Disney provide pages and pages of information for investors. Try clicking on Investor Relations from the Disney home page at www.disney.com. Immediately, you should see their goal for the shareholder and some choices like:

- Financial Publications
- Earnings Releases
- Disney Investment Plan
- Latest News
- Frequently Asked Questions

Each one of these links provides more detailed information about why Disney believes that you should invest in their company. The last sentence has a very important concept that you should be aware of. The Disney company is providing you with information about why you should invest in their company. I am not suggesting, in any way, that Disney or any other company is going to provide you with false information, but that they will try to show you the most good. We just want you to be aware of where the information you are reading is coming from, so you do not start reading it and think that, "Oh my! I can't go wrong with Company X!"

Other less biased source of information is S&P Stock Reports and Value Line Stock Reports. Many brokerages provide these reports to you either free or for a small fee. Reading up on a stock could be very useful.

Introduction to Course 206 Advisory Services… What You Need to Know!

Since the inception of the Stock Market, someone has claimed to know a way to beat it. Many have spent a lifetime and their fortunes trying. Many have succeeded and many have failed. Although, I have not been able to acquire convincing facts, I would guess that more have succeeded than have failed, but that leads to a very interesting problem.

Many of these people who have been successful, with their success as proof, now claim that they are masters of the market and begin to advise others how to master the markets as well. Beware. That is my warning to you, if you want to blindly follow the advice of someone else who claims that they have mastered the market.

There are thousands of financial advisors and financial newsletters and some of them have great track records for the past five years, ten years or twenty years. This is only half of the picture though. What they market did in the past five, ten or twenty years is not necessarily indicative of how it will be next year and this is part of the danger of using a financial newsletter to invest your money.

In this course, we will go over just where a financial newsletter can help you. We will go over how to pick a newsletter, especially what to look for and what to avoid. We will also show you how to test a financial newsletter to see how it would have done for you.

Can Advisory Services Help Profitably Invest in Stocks?

The most basic question concerning advisory services and newsletters (and I will use them interchangeably throughout this course) is, "Can they help me?" The answer is yes. However, they may help you in a way that you never really anticipated. Let me explain.

Some advisory services just tell their subscribers which stocks or funds to buy or sell and when. Most, however, inform their subscribers to changes in the markets and explain why they pick the stocks or funds that they do. This is where an advisor can help you.

Advisors, most of them with a fair amount of market experience, can be great teachers of what to look for in markets and what to look for when researching stocks. This is the most useful aspect of an advisory service or newsletter: the teaching aspect.

Some people wonder if an advisory service can really be profitable. I am one of them. However, some advisors have shown that over the last 20 years, they have been profitable. That deserves at least a second look. Later in this course, we will look into testing an advisory service and how to pick one. But, I feel that the greatest help an advisory service can be to you is to show you how to analyze the markets.

Picking a Stock Advisory Service

There have been stock competitions held over the years where the so called experts have been placed up against secondary school kids, high school kids, college kids, throwing a dart at a list of stocks and monkeys picking random index cards out of a bag. In some of these competitions, surprisingly enough, the monkeys picking random index cards out of a bag or the random dart throw has outperformed the experts. So, could the same be said about choosing a financial advisor? Well, I do not think so.

As we discussed in the last topic on Can Advisory Services Help, we talked about how they help: namely, they help teach you about the markets. So when you are looking for an advisory service, you might want to look for more than just the rate of return on investment for the last five, ten or twenty years. You might also consider who is giving the advice, how he determines his investments, how long has he been trading and why is he qualified to be an advisor.

Now, I am not saying that you should not be concerned with how well the service has done. Quite the contrary, I am saying you should be concerned with how well the advisor has done and why he has done that well. Is it that he owns intelligent monkeys that pick great stocks consistently or that he knows how to research stocks and find good value?

To find a good advisory service I recommend visiting your library or bookstore and checking out a book that rates different advisory services. In our recommended reading list, I list one that I use. After reading that book, I recommend that you subscribe to one or two that interest you. Often times, you can get a test subscription to these services for a few dollars. If you think that this service can teach you something, then take out a six month or year-long subscription and actually *use* it.

So many people that I know subscribe to things and never actually use them. I could speculate that it is human nature to want things and then not to put them to full use, but I plead with you: if you are going to spend the money on an advisory service, use it and learn from it.

Testing a Stock Advisory Service

So you finally have picked out a few advisory services that you think could teach you a lot about the markets. You decide to subscribe to two of them on a trial subscription. Now what?

Immediately, open an imaginary account with about how much you would be investing and see how it does. Pretend that it is real money you are trading with. Deduct commissions. Sweat it out if you are down 75% in the first two months! This step is invaluable since this is what would have actually happened had you followed their advice. Keep track of how this account would have done for the length of your subscription. This is only half of what you should do to test the advisory service.

The second test is just as important as the first, if not more important. Open a second imaginary account with the exact same amount of money as the account you set up in the paragraph above. Using the information you learned from the advisor about how he invests in markets and why, pick your own investments and track their performance. Why should you do this? Because this will help to reinforce what you are being taught by the advisor and make you less dependent on the advisor. Remember, the goal here, besides making money, is to teach you how to make money. The biblical adage, about giving a man fish and him eating for day versus teaching a man to fish and him eating for a lifetime is true. Do not let an advisor fish for you when he can teach you to fish for yourself.

Introduction to Stock Course 207

Thanks for committing to accomplishing your investment goals and coming this far. You are to be commended. By now, you should know the basics of reading stock charts and some simple, powerful strategies for investing in stocks. In Stock Course 203 you learned about options and some lucrative option strategies. Mutual funds, as you learned in Stock Course 204, can be a great way of diversifying your portfolio and easing the demands of actively managing your accounts. With Stock Courses 205 and 206 you learned how to find and decide which stocks that are right for you to invest in.

All of the information you have acquired so far is powerless unless you have a means of buying and selling stock, mutual funds and options. Stock Course 207, Placing Your First Trade, solves this problem and teaches you exactly what you need to know to start trading today.

Picking a Stock Broker

The task of picking a broker can be daunting. You may encounter terms like Full Service, Discount and Financial Advisor or Planner. Relax, it is easy to understand. We have already explained the difference between Full Service Brokers and Discount Brokers here as a preface to the Learn Investing's World Wide Broker Database. As for Financial Planners and Advisors, these individuals help your allocate your investments... for a fee. I assume, since you are here actively learning how to invest your own money, that you will not want or need a Financial Planner or Advisor.

What should I look for in a broker?

If you do decide to go with a Full Service broker and opt not to use an order desk with a discount firm or trade on-line via the internet, you will want to use a broker that you trust and that you get along with. Investing is fun. If you dread calling your broker, you should get a different broker.
At the Learn Investing, we recommend contacting a few brokers and "picking their brains." See what strategies they use. See what they think of your strategy. Ask them questions about your strategy and some other strategies you considered. How do their strategies compare with the ones that you had in mind?

Be careful...

Do not let a broker convince you to try their trading strategy without thoroughly thinking it through yourself. Just because a broker recommends a strategy does not make the strategy fool proof. Remember also, brokers make their money on commissions. So, be wary of trading styles that have you making lots of trades. This may be great for the broker's paycheck, but I question how good it is on your trading account.

Most brokers will be helpful...

The majority of brokers are really there to see you do well. These brokers understand that if you do well, you will, more than likely, stay with them for a long time. This is best for you and the broker in the long run.

The key to picking a broker...

The key to picking the right broker is to test a few. Find one that is both knowledgeable and personable. The broker that is right for your Uncle may not be right for you. So you will really have to look for yourself. On the other hand, if you are just looking to place orders, you may consider trying a discount firm and/or trading via the internet. We tell you everything you need to know about on-line trading.

Types of Stock Market Orders

The stock market allows you to make use of some very powerful orders. Below is a list of some of the more common orders. In Placing Orders we will discuss exactly how we use these orders to make a trade. In Examples of Trades, we will discuss some specific examples of orders.

Market Order
Limit Order
Stop Order (Stop-loss Order)

Placing Stock Market Orders

The experience of placing stock, stock option or mutual fund orders varies dramatically depending on whether you decide to use an on-line (Internet based) order system, a touch tone automated telephone system or a live broker. The experience even varies depending on whether you use a full service live broker or discount order desk.

The basics of placing stock, stock option or mutual fund orders remain relatively constant however. Here's an outline of the key components.

1. Which stock or mutual fund?
2. Buy or Sell?
3. How many shares?
4. Using what type of order?

Let's explain these steps and go over an example

Examples of Stock Market Orders and Cancels

In this topic we will cover examples of how we would form and place an order and even cancel it.

What to Buy?

First decide on a stock to buy. This is step one.

Price Going Up or Down?

Step two, you want to decide is whether the price is going up or down.

If you think the price is going up, you want to go long or buy.
If you think the price is going down, you want to go short or sell.

How much to buy?

The next step is to determine how much you want to buy or sell. You can think of it in terms of number of shares or a dollar amount which you will convert to number of shares.
If you decide you want to buy 90 shares, then you would take the dollars per share and multiple it by 90 to determine how much you will be investing.
If you decide you want to buy $550 worth, then take $550 and divide by the dollars per share to get the number of shares you are going to buy.

What type of Order?

After you have decided whether to buy or sell and how much, next decide how you want to buy it. If you just want to get in the market to start a long term position, you may consider just placing a market order. To get in only at a certain price or better, try a limit order. If you want to enter only if the stock reaches a certain threshold price, use a stop order. To review these orders, click here.

Putting it All Together

Now you are ready to put your order together. Follow along in this example.
You picked a stock based on your own research. Its symbol is WXYZ. You decided the price of a stock is going up, you would buy. Next you decide you want to invest $900. So you need to calculate approximately how many shares that is. $900 divided by the dollar per share. The shares are currently trading at $9 each. That means you can buy 100 shares ($900/$9 per share = 100). So now we know to BUY 100 shares of WXYZ. Now, we need to determine what kind of order we should use. In this case, you are adding this to your long term portfolio for retirement and you are not concerned about using a limit or stop order. You decide to place a market order. The final order would be:

Buy 100 shares of WXYZ at the market.

That's how easy it is.

Stock Commissions & Fees

Trading stocks is always a profitable experience... for brokers. There is a commission paid on each order you have executed by a broker. The commissions vary depending on how you place you order.

- On-line orders are usually the cheapest.
- Automated telephone orders are slightly more expensive.
- Live broker orders are the most expensive.

You should also know that some brokers will charge more for different types of orders. For example, to place a limit order may be more expensive than placing a market order. Some brokers also charge an extra fee if you are buying more than so many shares of a particular stock. For instance, if you are looking to buy 8,000 shares of stock XYZ, they may charge you $19 for the first 5,000 shares and a couple of cents for each share thereafter. Those couple of cents, can really add up fast. For an additional 3,000 shares, even at a penny extra per share over 5,000, you are paying $30. Remember, it only cost $19 for the first 5,000!

What about other fees?

As a general rule, if you seek the advice of a professional broker or financial advisor, you are going to pay for it. It could be in the form of a higher commission, in the case of a broker, or in the form an advisory fee, in the case of a financial advisor.

- Some brokerages will charge you a fee if you do not maintain a minimum balance. Others will charge you for an IRA account below a certain value. There are brokerages out there that do not charge fees for these types of things.
- Some brokerages will charge you for real-time (or up to the minute) stock quotes. Others will not.
- Some may charge you to write checks for your account. Others will not.
- Some will offer you a selection of no load mutual funds. Other will not.
- Some may charge you to deliver your stock certificates (which is usually unnecessary anyway). Other brokerages will not.
- Some will charge you for S&P Stock Reports or news. Others will not.

There are plenty of brokerages on-line that offer extremely reasonable rates and excellent service. The most important thing is for you to be comfortable. More and more people are finding that they are comfortable trading on-line and saving money doing it. Shop around! In Trading on the Internet, we cover some of the concerns regarding trading on-line.

Trading Stocks on Margin

By now, you have learned the majority of the essentials to trading stocks. However, there are two things you have yet to learn. One thing is the differences between trading with a broker or automated telephone system and trading on-line via the Internet. We will cover those differences in the next topic Trading on the Internet. In this topic we will cover the other thing that you have yet to learn... Trading on Margin.

What is Margin?

Think of margin as a low interest loan that can be used to trade stocks. It allows you to buy twice as much of certain stocks.

Here's How it Works

Assume you want to buy 100 shares of stock XYZ. It is currently trading at $10 per share. To buy 100 shares it would cost you $1,000 ($10 per share times 100 shares = $1,000). However, if you open a margin account with your broker, you can actually buy $2,000 worth of stock. $1,000 on cash and $1,000 on margin. The $1,000 you "borrowed" on margin is subject to an interest charge however.

Why would I want to do that?

For most people, I do not recommend over extending themselves and buying stocks on margin, but you can do some interesting things with a margin account. If you have an account with your broker that you can write checks with, you can actually use the margin amount as a revolving credit line.

What?

Assume you have $10,000 in various stocks in your account. You have a margin account, but you have not bought any stocks on margin. Since the interest charged on a margin account is usually less than a credit card, you could actually write a check from your account (if you have this ability with the account you open) even though you have zero dollars in cash in that account. Since you could buy the full $10,000 worth of stocks with only $5,000 deposited in the account (provided that all of the stocks were able to be bought on margin), you have a $5,000 revolving credit line. It gives you some flexibility with your finances for emergencies.

Trading Stocks and Stock Options on the Internet

Trading stocks on the Internet is both safe and easy. With the vast amount of information at your fingertips at most of the on-line brokerages, it is much easier to research stocks on-line. The obvious next step is to just go to the on-line order placement web and place your order. This can be extremely convenient, but with good comes bad.

Beware!

Make sure that you enter the correct order. Double check it. Triple check it. When you use an on-line order system, there is not a broker there to tell you that you if you think the price is going down, that you should try to sell short the stock and not buy it. I recommend highly using a simulation service before you actually start trading.

Lower Prices!

As we discussed earlier the stock commissions and fees for trading on-line are usually much lower that calling a broker. This is a great advantage to you.